



**Actuarial Office**

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**May 16, 2006**

**AGENDA ITEM 9**

**TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION  
COMMITTEE**

**I. SUBJECT:** State and Schools Employer Contribution Rates for  
the Fiscal Year July 1, 2006 through June 30, 2007

**II. PROGRAM:** Actuarial & Employer Services

**III. RECOMMENDATION:**

That the Committee recommends to the full Board the adoption of the employer contribution rates for the State and Schools for the period July 1, 2006 to June 30, 2007 as set forth in the table on the following page.

**IV. ANALYSIS:**

**State and Schools Employer Contribution Rates for 2006-2007**

The Actuarial Office has completed the calculation of the employer contribution rates for the State and Schools for the fiscal year July 1, 2006 through June 30, 2007. A full actuarial report will be mailed under separate cover.

The table on the following page compares the fiscal year 2006-2007 contribution rates and the dollar amounts these rates are anticipated to generate with rates and contributions for the current fiscal year July 1, 2005 through June 30, 2006.

	2005-2006 Fiscal Year		2006-2007 Fiscal Year	
	Employer Contribution	Employer Rate	Employer Contribution	Employer Rate
State Miscellaneous Tier 1	1,359,914,069	15.942%	1,428,596,340	16.997%
State Miscellaneous Tier 2	87,130,740	15.890%	82,561,067	16.778%
State Industrial	64,756,013	17.147%	67,783,974	17.861%
State Safety	169,202,209	19.026%	213,573,959	19.294%
State Police Officers & Firefighters	613,465,894	23.563%	700,913,721	24.505%
California Highway Patrol	134,251,702	26.396%	171,833,063	31.463%
<b>Subtotal State</b>	<b>\$2,428,720,628</b>		<b>\$2,665,262,125</b>	
Schools	826,672,339	9.116%	841,504,282	9.124%
<b>Total</b>	<b>\$3,255,392,967</b>		<b>\$3,506,766,407</b>	

Please refer to Attachment 1 for the development of the employer rate for each plan.

### Reasons for Changes in Employer Contributions

Overall, the required contributions for all State plans are increasing by \$239.4 million between fiscal year 2005-2006 and fiscal year 2006-2007. The reasons for the changes in employer contributions for the State between fiscal year 2005-2006 and fiscal year 2006-2007 are as follows:

<u>Reason for Change</u>	<u>Change in Required Contribution (millions)</u>
Normal progression in payroll (current year's rates applied to coming year's expected payroll)	\$ 82.5
Benefit Improvements	
• SB 439 of the 2003-2004 legislative session applicable to CHP <sup>(1)</sup>	22.5
• Senate Bill 183 of the 2001-2002 legislative session <sup>(2)</sup>	11.6
Actuarial gains and losses	
• Greater than expected salary increases <sup>(3)</sup>	72.3
• Greater than expected number of retirements <sup>(4)</sup>	46.2
• Demographic losses among benefit recipients <sup>(5)</sup>	30.5
• Other demographic losses <sup>(6)</sup>	27.9
• Greater than expected investment return <sup>(7)</sup>	(30.6)
• Greater than expected contributions received in fiscal 2004-05 (higher than expected payroll)	<u>(23.4)</u>
Total Change in required contributions	\$239.5

- (1) Senate Bill 65 of the 2001-2002 legislative session provided a temporary (set to expire in 2006) benefit to CHP members that increased the final compensation used for calculating the retirement benefit by an amount equal to the member contribution. SB 439 of the 2003-2004 legislative session made this benefit permanent. This benefit change is being reflected for the first time in the June 30, 2005 actuarial valuation.
- (2) Senate Bill 183 of the 2001-2002 legislative session reclassified certain State Miscellaneous members in Bargaining Unit 7 as State Safety members effective July 1, 2004. This reclassification is being reflected for the first time in the June 30, 2005 actuarial valuation. Overall, close to 3,600 members were reclassified.
- (3) Salary increases in 2004-2005 included an across the board 5% pay increase to State miscellaneous members to offset the resumption of 5% of pay employee contributions to CalPERS and larger increases in pay to POFF (average pay increased 12%) and CHP members.(average pay increased 10%).
- (4) Greater than expected number of retirements. The number of State retirements increased by about 24% in fiscal year 2004-2005 and was 50% greater than expected by the actuarial assumptions. Records to date indicate that this while the number of retirements in fiscal year 2005-2006 continues at a higher level than anticipated by the assumptions, the growth in retirements between fiscal year 2004-2005 and fiscal year 2005-2006 has slowed significantly (about a 2% growth rate). We don't believe that this increase was due to SB 400. When SB 400 costs were determined they were based on an expected increased level of retirements. The CalPERS actuaries conducted an experience study which was based on the three years of experience that followed the implementation of SB 400. The study showed that the number of retirements after SB 400 were lower than anticipated in the SB 400 cost analysis. Since the completion of that study we are now seeing an increase in retirements. While one may speculate about several factors which may account for this increase in retirements, it is too soon to determine if this increase in the number of retirements will continue in the future. One possible reason for this spike in retirements is the ability to purchase Additional Retirement Service Credit (Airtime). This will have to be monitored closely in the next few years. Once sufficient data is available, a study to determine the causes and impact of this pattern will be undertaken. It is possible that retirement assumptions will have to be modified or increases in the purchase cost of airtime may be needed.

- (5) This loss includes less than expected mortality and greater than expected cost-of-living increases. The cost-of living increases were greater than the statutory 2% due to the catch-up provision. The catch up provision provides that in years when actual inflation is less than 2% that amount below 2% will be added to future years when inflation is above 2%. This occurred in 2002-2003 when inflation was about 1.6%. With respect to mortality, there were about 800 fewer deaths among benefit recipients than were expected by the actuarial assumptions. In analyzing this issue, it was determined that this did not occur in fiscal 2003-04 and there is no reason at this time to assume that there is a pattern developing. This also will be closely monitored in the future.
- (6) This includes gains and losses due to demographic experience for transferred and separated members such as increases in salaries greater than expected as well as adjustments to assets to account for receivables for service credit purchase and conversion of second tier service to first tier.
- (7) The asset return on a market value basis was approximately 13% for fiscal 2004-05. As it was meant to do, the new rate smoothing methodology substantially dampened the impact of this better than expected return. In order to have the desired smoothing impact, the new smoothing methods must be applied both when returns are greater than expected and when they are less than expected.

For the schools pool, the required contributions are increasing by \$16.1 million. This increase in contributions is caused mainly by the normal progression in required contributions due to expected growth in payroll.

Attachment 2 provides the total employer rate and contributions for each plan broken down into its major components as well as a reconciliation of the rate and contributions between the two fiscal years.

## History of the Expected Contribution Requirements

The following table shows the history of expected employer contributions for the State plans and the Schools pool going back to fiscal year 1996-1997.

<b>Fiscal Year</b>	<b>Total State Contributions</b>	<b>Total School Contributions</b>
1996-97	\$1,236,447,373	\$ 416,694,314
1997-98	1,223,327,746	317,571,853
1998-99	766,067,149	0
1999-00	159,460,097	0
2000-01	156,722,747	0
2001-02	677,244,769	0
2002-03	1,189,559,722	228,972,653
2003-04	2,212,518,481	869,501,830
2004-05	2,547,364,178	903,570,002
2005-06	2,428,720,628	826,672,339
2006-07	\$2,665,262,125	\$841,504,282

## Funded Status

As mentioned to the Board in the February Finance committee meeting, we are monitoring the funded status of the State and School Plans using the market value of assets to ensure that the new rate stabilization methods do not impair the security of benefits. The table below shows the funded status of the plans using the market value of assets. These results show that the funded status on a market value basis is greater than that using the smoothed actuarial value of assets. Further, the funded status on a market value basis has improved between 2004 and 2005.

<b>Funded Ratio of the Retirement Program (Based on the Market Value of Assets)</b>		
	<b>June 30, 2004</b>	<b>June 30, 2005</b>
State Miscellaneous	83.1%	86.2%
State Industrial	88.3%	90.4%
State Safety	81.3%	86.4%
State Police Officers & Firefighters	83.0%	84.4%
California Highway Patrol	78.7%	79.4%
<b>Subtotal State</b>	<b>82.1%</b>	<b>85.5%</b>
Schools	91.4%	96.2%

The following table shows the funded ratio of the plans based on the smoothed Actuarial Value of Assets. The funded status on an Actuarial Value of Asset basis is used for rate setting only and is not a true measure of the plan's ability to pay benefits.

<b>Funded Ratio of the Retirement Program (Based on the Actuarial Value of Assets – Used for Rate Setting)</b>		
	<b>June 30, 2004</b>	<b>June 30, 2005</b>
State Miscellaneous	84.3%	83.6%
State Industrial	89.7%	88.0%
State Safety	82.1%	83.5%
State Police Officers & Firefighters	84.2%	82.0%
California Highway Patrol	80.1%	77.0%
<b>Subtotal State</b>	<b>84.1%</b>	<b>82.9%</b>
Schools	92.7%	93.3%

Refer to Attachment 3 for the development of the accrued and unfunded liabilities as well as the funded ratio for each plan and to Attachment 4 for the development of the actuarial value of assets for each plan.

### **An Outlook for Fiscal Year 2007-2008**

For the June 30, 2005 valuation, the asset smoothing method used to determine the actuarial value of assets resulted in an actuarial value of assets equal to about 97% of the market value for all plans. Using an actuarial value of assets that is less than market value means that not all prior investment gains have been fully recognized.

As a result, as long as the market value rate of return is greater than 4.5% in fiscal year 2005-2006 then additional investment gains will be recognize in the June 30, 2006 valuation. In such cases, these investment gains will help lower the rates for fiscal year 2006-2007 if all other assumptions are realized.

In addition, SB 65 of the 2001-2002 legislative session provided the 3% at age 50 benefit formula for all State Peace Officer/Firefighter members employed in Bargaining Unit 6 and related position on or after January 1, 2006. This benefit increase will be reflected for the first time in the June 30, 2006 actuarial valuation and is expected to increase the State contribution for the State Peace Officer/Firefighter plan by about 1.4% of payroll.

**V. STRATEGIC PLAN:**

This item is not a specific product of the Strategic or Annual Plans but is part of the regular and ongoing workload of the Actuarial Office.

**VI. RESULTS/COSTS:**

See attachments.



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